Power Plant Construction Costs: Recovery Paused as Costs Go Flat Once More

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North American costs hold, European costs rise due solely to currency exchange rates

The costs of building new power plants flattened during the Q1 2010 – Q3 2010 period after rising six months ago for the first time since 2008, according to the latest IHS CERA Power Capital Costs Indexes (PCCI) for North America and Europe. Rising costs of raw materials kept the index flat for North America while the weakening euro caused the European index to rise.

A proprietary measure of project cost inflation similar in concept to the Consumer Price Index (CPI), the IHS CERA PCCIs track construction costs for building coal, gas, wind and nuclear power plants in both regions and is indexed to the year 2000. The PCCI for North America registered a flat 215, indicating that a portfolio of power plants that cost $100 billion in 2000 would, on average, cost $215 billion today. The European index score now stands at 194. Absent the exchange rate, the European index would have posted a slight drop.

“The previous rise of power plant capital costs during Q3 2009 – Q1 2010—the first after a prolonged decline—reflected more of a bottoming out than a reversal of momentum,” said IHS Senior Director of Cost and Technology, Candida Scott. “Costs are holding relatively flat and the underlying trends for both North America and Europe remain very similar.”

North American costs were held steady during the Q1 2010 – Q3 2010 period as subtle movements within individual markets served to counteract one another. Major equipment costs fell 1 percent as new orders remained low, with coal seeing the most movement down due to lack of interest and orders. Orders for wind and gas remained sluggish. The index was balanced by a rise of steel costs (3 percent) as supply responds to increases in demand for steel products, and by small increases in construction labor costs and ancillary equipment.

These underlying cost trends in steel and ancillary equipment were broadly similar for the Europe index, though the movements of these markets were amplified by the weakening of the euro against the U.S. dollar. Engineering and project management costs remained flat for both continents due to the slowing recovery to the global economy. The market for major equipment such as coal boiler and gas and wind turbines has yet to recover. The outlook for coal equipment orders looks dismal, but orders for gas and wind are anticipated to pick up by the end of next year. However, competition in the over-supplied global wind turbine markets is fierce and the potential for an expanding presence of Asian manufacturers may well have an impact on costs in the future.

While steel costs for the semi-annual indexes have risen steadily since Q3 2009 the slowing economic recovery could reverse some of the gains in the near term, said Roger Kranenburg, director, IHS CERA Capital Costs Analysis Forum – North American Power.

“While steel costs were up again on the index, they did begin to show weakness at the end of Q3 2010,” Kranenburg said. “Managing volatility in these markets is likely to remain a key factor for success in the future.”

Construction labor costs continue to be one area where North America and Europe diverge, however. While both regions posted gains labor rates are slowing in Europe, where unemployment and austerity measures have even led to a fall in labor costs in local currency terms for some countries.

“Europe remains in a period of lower-than-trend growth due to a slower economic recovery compared to other global regions,” said Deborah Mann, director, IHS CERA Capital Costs Analysis Forum – European Power. “Costs of major equipment are still under pressure but Europe is likely to see rising costs for other materials driven by accelerating demand elsewhere. High unemployment will ensure that labor costs remain very depressed in some European countries.”
IHS CERA expects power capital cost in aggregate to rise gradually for North America in the near term while remaining flat in Europe. Varying growth rates by fuel are expected as the multi-speed global economic recovery plays out also as a multi-fuel power capital cost recovery.

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*About the IHS CERA Power Capital Costs Index (PCCI)*

The IHS CERA PCCI tracks the costs of equipment, facilities, materials and personnel (both skilled and unskilled) used in the construction of a geographically diversified portfolio of more than 30 power generation construction projects throughout North America. The PCCI for Europe is based on a separate diversified portfolio of European projects. The PCCI is analogous to the consumer price index (CPI) in that it provides a clear, transparent benchmark tool for tracking and forecasting a complex and dynamic environment. The PCCI for each of the two portfolios can be tracked on the IHS Index Web Site at www.ihsindexes.com. The PCCI is a work product of IHS CERA’s Capital Costs Analysis Forum for Power (CCAF-P). For information on the Capital Costs Analysis Forum for Power, contact Ken Downey at ken.downey@ihs.com

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